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northwest economic indicators

National Outlook

January 17, 1980

Highlights

- **Another double-digit inflation rate will be with us this year even though the month-to-month trend should improve as the year progresses. Poor productivity performance and accelerating energy costs are the main reasons.**

- **Workers, outside of a few industries with generous cost-of-living clauses, will not be able to keep up with inflation. Their pocketbooks and their confidence will be battered.**

- **President Carter's move to gradually decontrol U.S. oil prices will mean that the price of domestic oil will rise faster than that of imported oil. On the average, the overall cost of crude oil will rise about 50 percent over 1979.**

- **Labor and energy costs will keep food prices moving up. However, agricultural commodity prices should limit food price gains to less than 9 percent this year.**

- **American industries are well poised for the current economic recession. Inventories are lean and labor hoarding is not commonplace.**

- **Industries related to consumer-cyclical, construction, and heavy capital equipment other than computer-related will fare relatively poorly. On the other hand, those industries which make products to improve productivity and cut costs will perform relatively well.**

Dr. Sung Won Son
Senior Vice President and
Chief Economist

Inflation

Double-digit inflation last year is history now. Prices of lettuce, hamburger, airline tickets, out-of-town lodging, taxi fare, restaurant meals and a lot more have shown double-digit gains. No wonder, a cynic suggested that the Susan B. Anthony Dollar should be called a Lavern and Shirley Quarter.

Are we in for more pleasant tidings in this new year? Maybe. Later in the year, inflationary pressure is expected to moderate. For most of the year, however, prices and taxes will rise faster than consumer's income, battering their purchasing power.

Don't be too disappointed, you may be able to find quite a few bargains. Need a house? Sliding demand as a result of high mortage rates and rising unemployment should slow the rise in home prices. Of course, your new house will need furniture and appliances. Again you are in luck! Weak demand, high inventory costs and heavy competition will produce quite a few good buys.

Don't plan on setting your thermostats above 60 degrees though. Natural gas could cost 15 to 20 percent more this year. Cost of a gallon of fuel oil may hit $1.50 by year-end. Electricity costs will rise up to 10 percent. Despite the rising heating costs, you will be able to keep warm. Thanks to fierce competition from imports and softening demand, clothing may be one of the best buys. So, get several sets of long johns and bundle up!

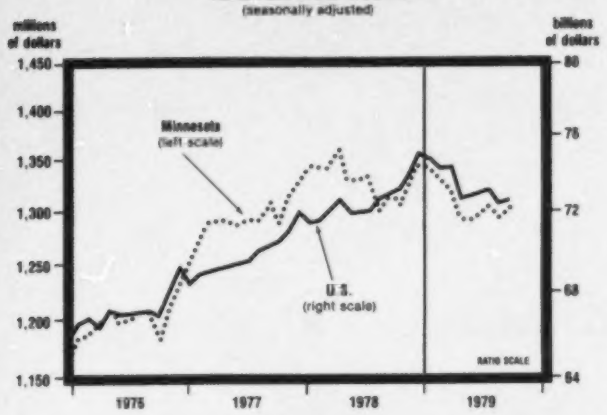
You will need that warm, cozy feeling in your attractively furnished house because you may not be able to go any place. Gasoline for your car and jet fuel for airplanes will cost you dearly. Even if you could get away, lodging and entertainment will bore a hole in your wallet. How about friends and relatives you planned to visit? You may have to settle for long-distance calls. The Bell System says that long-distance rates should not go up very much if at all.

The point of the above discussion is that anything which uses labor and energy will get more and more expensive. A consolation prize is that the weakening economy should produce a few attractive buys. Let's study costs of labor and energy in some detail.

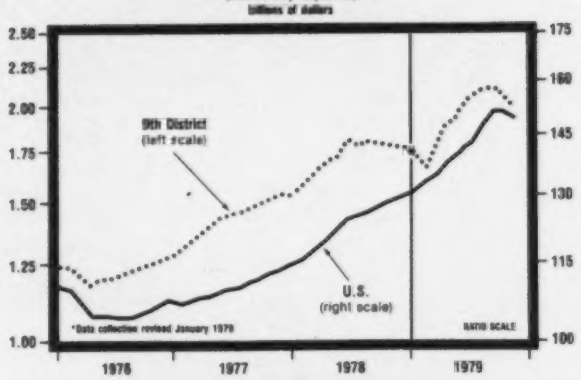
Wages: Three-fourths of costs are traceable to wages and benefits adjusted for any productivity gains. Using economists' jargon, it is called "unit labor costs."

REGIONAL ECONOMIC CONDITIONS

REAL PERSONAL INCOME
(seasonally adjusted)

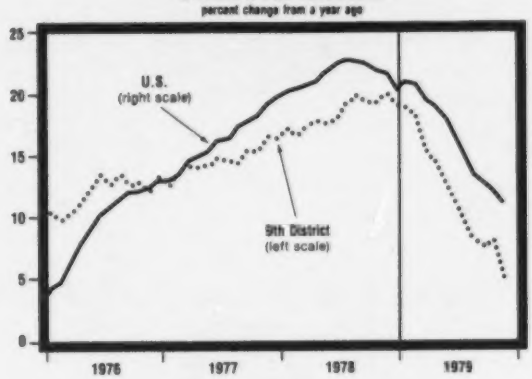


COMMERCIAL AND INDUSTRIAL LOANS
OUTSTANDING AT LARGE COMMERCIAL BANKS
(seasonally adjusted)
billions of dollars

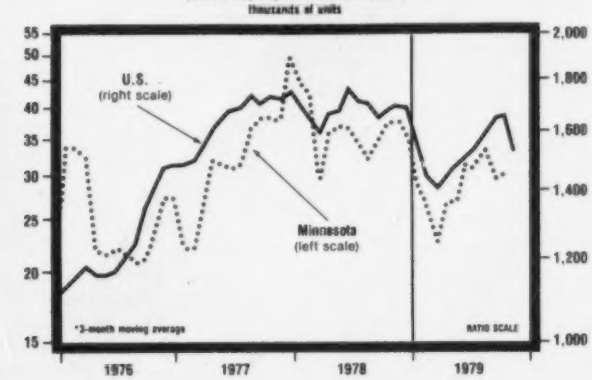


REAL RETAIL SALES
(seasonally adjusted)

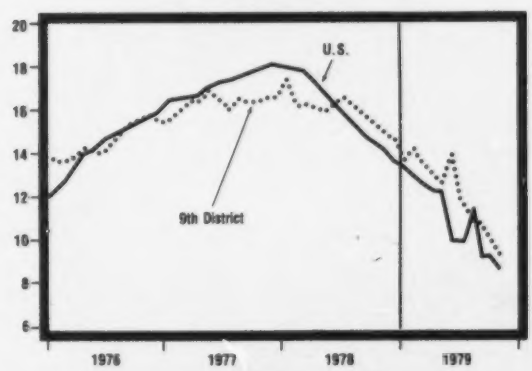
CONSUMER INSTALLMENT CREDIT
OUTSTANDING AT COMMERCIAL BANKS
percent change from a year ago



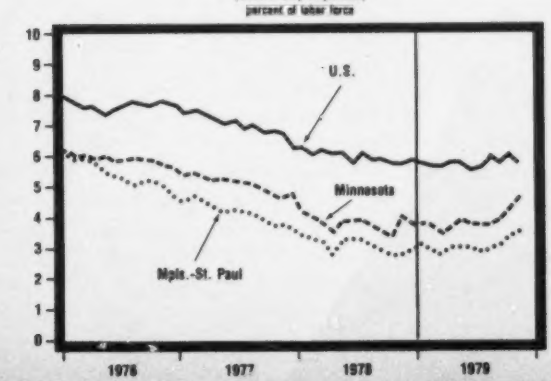
HOUSING PERMITS
HOUSING UNITS AUTHORIZED BY BUILDING PERMITS
(seasonally adjusted annual rates*)
thousands of units



MORTGAGE LOANS
OUTSTANDING AT SAVINGS AND LOAN ASSOCIATIONS
percent change from a year ago



UNEMPLOYMENT RATES
(seasonally adjusted)
percent of labor force



CONSUMER PRICE INDEX
ALL ITEMS, ALL URBAN CONSUMERS
percent change from a year ago

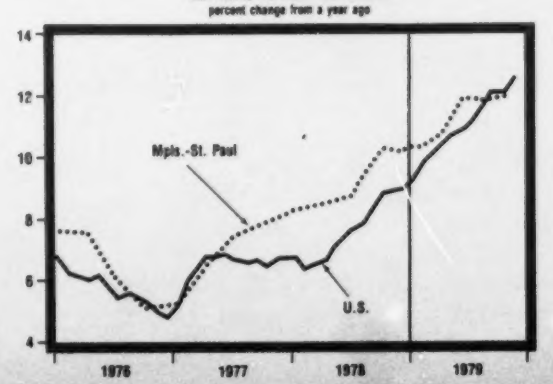


Table I
UNIT LABOR COSTS AND CONSUMER PRICES
(percent change per annum)

	Productivity*	Compensation per hour	Unit Labor Costs**	Consumer Price Index
1948-53	3.6%	6.2%	2.5%	2.2%
1953-58	2.5	4.6	2.1	1.5
1958-63	3.2	4.2	0.9	1.2
1963-68	3.2	5.8	2.5	2.6
1968-73	1.9	7.1	5.0	5.0
1973-78	1.0	8.9	7.8	8.0
1977	1.9	8.0	6.0	6.5
1978	0.5	8.5	8.0	7.7
1979 (estimated)	−1.7	8.0	9.9	11.3
1980 (projected)	−0.9	9.1	9.8	10.8

*Output per hour, private business sector
**Compensation less productivity
Source: Bureau of Labor Statistics, Northwestern National Bank Estimate.

Table I shows a close relationship between unit labor costs and the consumer price index. For example, productivity in the private business sector declined during 1979 while compensation accelerated. The combination of lower productivity and compensation pushed unit labor costs to about 10 percent. Not surprisingly, the average price increase last year roughly paralled the change in unit labor costs.

This year, productivity declines and wage gains are expected to accelerate. Without any help from productivity gains, all wage and benefit increases will go straight into inflation. This is one of the main reasons behind another double-digit price rise this year, even though the price trend should improve toward year-end.

This does not mean that workers will get rich and fat. To the contrary, worker's purchasing power has been falling for quite a while and there is no early prospect that this lost purchasing power will be restored. Only workers in the auto, steel, rubber and a few other industries with generous cost-of-living clauses (COLA) will be able to stay ahead of inflation. For example, auto workers may receive as much as 14 percent wage increases this year. While these contracts get a lot of publicity, they cover only a few million of the nearly 98 million employed Americans.

However, the number of workers protected by COLA may swell as the year progresses. As shown in Table II, over three and a half million private sector employees in major unions are scheduled to negotiate new contracts this year. The major unions include the steelworkers, carpenters and other construction workers, communication workers, and electrical workers. No doubt, the union workers will attempt to and succeed in neutralizing the corrosive impact of inflation on their buying power.

For a majority of workers, three key factors, the unemployment rate, productivity gains and President Carter's pay advisory committee, will prevent wages and benefits from rising as fast as overall price increases.

The rising unemployment rate and slack labor market this year will tend to slow wage increases. In addition, with no productivity gains in the economy, the management is less likely to grant wage increases. The pay advisory committee, which has proposed a 7.5 to 9.5 percent range for wage and benefit increases in 1980, will have a dampening impact on pay increases. In short, compensation gains, which tend to account for a lion's share of inflation, will average about 9 to 10 percent this year.

Table II
MAJOR INDUSTRIES FACING LABOR NEGOTIATIONS

MONTH	INDUSTRY
January	Oil, Chemical and Atomic Workers, Tobacco Workers
March	Glass Bottle Blowers
April	United Steelworkers
May	United Steelworkers, Aluminum Workers
June	Utility Workers
August	Communications Workers of America, Electrical Workers and Telecommunications International
September	International Longshoremen's Association, Amalgamated Clothing and Textile Workers
October	International Association of Machinists, United Auto Workers, Amalgamated Transit Union
December	Seattle Professional Engineering Employees Association, Service Employees International Union

Source: Bureau of Labor Statistics.

Energy: Let us turn to another important source of inflation: energy. Last year, Americans paid about $60 billion for imported oil. This year, the oil bill from abroad will exceed $100 billion. In addition to the skyrocketing price of foreign oil, President Carter's mc to gradually decontrol U.S. oil prices will continue to add costs to all oil-based fuel and products. In fact, Table III shows that domestic oil prices are projected to go up faster than imported oil costs this year.

One benefit of rising energy costs and occasional gas lines has been a reduction in energy demand here at home and abroad. Oil consumption in the United States is running 2 to 3 percent less than a year ago. Gasoline demand fell 7 percent in the second half of 1979, and has been down as much as 10 percent in recent weeks. With higher costs of energy and a worldwide economic slowdown, demand should moderate further.

All these signs of weakening demand and bulging oil stocks led some analysts to believe that the worst energy price hikes may soon be over. This is a pleasant, but unrealistic, thought.

The events in Iran have made a number of oil-producing countries very sensitive to the effects on their political, social, and religious fabrics of the pace of development programs. The general pressure in many of these countries is to reduce oil production and to raise prices. Should the supply of oil be disrupted as a result of political upheavals, the price of imported oil could leapfrog toward the sky.

Barring an unexpected cutoff of oil supply, the 51 percent increase in domestic and crude oil as shown in Table III will reinforce the double-digit increase in the unit labor costs. In short, jumps in energy costs which added 3 percent to inflation in 1979, will continue to play havoc with inflation.

Food: During the first part of last year, food prices made a significant contribution to double-digit inflation. Poor weather was an important reason. No one can tell what Mother Nature will do this year.

Barring a major weather-related problem, processing, marketing and distribution costs account for three-

ECONOMIC OUTLOOK

January 1980

	Level			Percent Change from the Previous Quarter (annual rates)								Annual Percent Change		
	1978	1979E	1980E	1979E				1980E				1978	1979E	1980E
				I	II	III	IVE	IE	IIE	IIIE	IVE			
Consumer Price Index (1967 = 100)	195.5	217.6	241.1	11.1	13.6	12.9	13.0	10.1	8.4	8.9	8.2	7.7	11.3	10.8
Food	211.8	234.6	255.2	15.9	11.3	3.1	9.6	9.9	9.1	8.7	9.8	10.2	10.8	8.8
Nonfood Commodities	174.6	195.3	217.7	11.6	15.3	16.0	15.2	10.8	8.0	8.9	7.5	5.7	11.9	11.5
Services	211.2	233.9	258.4	8.2	13.1	14.3	12.5	9.6	8.4	8.9	8.0	8.6	10.7	10.5
Producer Price Index, Finished Goods (1967 = 100)	194.6	215.6	238.6	13.8	10.4	10.5	12.5	10.9	10.2	9.8	7.9	10.6	10.8	10.7
Compensation Per Manhour Nonfarm Private (1967 = 100)	229.2	247.5	269.9	10.4	8.1	8.6	8.0	10.0	9.3	9.2	9.2	9.2	8.0	9.1
Labor Productivity, Nonfarm Private (1967 = 100)	117.7	115.7	114.7	– 3.0	– 4.0	– 0.7	0.6	– 1.0	– 1.3	– 1.5	1.4	1.1	– 1.7	– 0.9
Unit Labor Costs, Nonfarm Private (1967 = 100)	194.6	213.9	234.9	13.7	12.1	9.4	7.6	11.0	10.1	10.7	7.8	8.1	9.9	9.8
Corporate Profits After Taxes, bil. $	121.5	145.1	134.6	32.7	– 7.4	28.5	7.5	– 16.1	– 29.0	– 5.4	0.0	16.3	19.4	– 7.2
Disposable Personal Income, bil. $ (1)	1458.4	1620.5	1743.3	13.0	7.7	9.9	7.1	4.8	7.0	11.0	10.5	11.7	11.1	7.6
Real Disposable Personal Income, bil. $ (2)	746.0	744.7	723.1	1.7	– 5.9	– 3.0	– 5.9	– 5.3	– 1.4	2.1	2.3	3.7	– 0.2	– 2.9
New Passenger Car Sales (millions of units)	11.3	10.6	8.7	11.6*	10.5*	10.8*	9.4*	8.8*	8.5*	8.5*	9.0*	11.3*	10.6*	8.7*
New Private Housing Starts (millions of units)	2.01	1.74	1.40	1.62*	1.83*	1.83*	1.67*	1.40*	1.30*	1.35*	1.55*	2.01*	1.74*	1.40*
Unemployment Rate, %	6.0	5.8	7.8	5.7*	5.7*	5.8*	5.9*	7.0*	7.9*	8.0*	8.2*	6.0*	5.8*	7.8*
Federal Government Deficit, bil. $	27.7	12.8	55.0	11.7*	7.0*	11.3*	21.0*	36.0*	60.0*	61.5*	62.6*	27.7*	12.8*	55.0*

E—Estimated.

(1) Take-home pay.

(2) Disposable personal income divided by the CPI.

*All figures are expressed as annual rates, not percent changes.

ECONOMIC OUTLOOK (Without Inflation)

January 1980

	Level (billions of 1972 $)			Percent Change from the Previous Quarter (annual rates)								Annual Percent Change		
	1978	1979E	1980E	1979E				1980E				1978	1979E	1980E
				I	II	III	IVE	IE	IIE	IIIE	IVE			
Gross National Product	1399.2	1430.7	1419.7	1.1	−2.3	3.1	0.9	−3.0	−3.0	−0.4	3.5	4.4	2.2	−0.8
Consumer Expenditures	900.8	922.4	917.6	0.7	−2.9	4.8	0.4	−3.1	−2.0	0.1	2.3	4.5	2.4	−0.5
Durables	146.7	146.1	135.5	−5.2	−13.4	5.7	−11.7	−13.6	−7.0	−1.3	3.9	6.1	−0.4	−7.2
Nondurables	343.3	348.1	345.9	−4.3	−4.4	6.1	2.0	−3.5	−3.2	−0.7	2.3	3.2	1.4	−0.6
Services	410.8	428.3	436.2	7.3	2.4	3.6	3.5	0.9	0.7	1.1	1.8	5.1	4.3	1.9
Investment	214.4	216.1	198.5	−0.5	8.5	−12.8	−5.4	−6.2	−22.8	−3.6	10.8	7.1	0.8	−8.1
Fixed Residential (1)	60.1	56.4	49.3	−14.4	−7.2	−1.0	−10.6	−25.4	−18.8	−2.8	10.9	4.2	−6.1	−12.7
Fixed Nonresidential (2)	140.1	149.4	152.2	4.8	−0.7	10.8	5.4	4.4	1.5	−10.2	−5.3	8.4	6.6	1.9
Structures	43.9	47.9	49.3	−5.9	19.6	6.8	5.0	3.9	2.1	−8.5	−4.6	12.3	9.1	2.8
Producers Durable Equipment	96.2	101.4	102.9	10.1	−8.9	12.2	6.0	4.6	1.2	−11.0	−5.7	6.7	5.4	1.5
Change in Inventories	14.2	10.3	−3.0	12.3*	18.1*	7.1*	3.6*	2.5*	−8.5*	−5.8*	0.0*			
Net Exports (3)	10.9	17.9	25.3	17.0*	13.1*	20.1*	21.6*	21.4*	27.2*	26.0*	26.5*	10.9*	17.9*	25.3*
Exports	108.9	120.2	128.0	117.0*	116.0*	122.2*	125.5*	125.0*	128.9*	128.0*	130.0*	108.9*	120.2*	128.0*
Imports	97.9	102.2	102.7	100.0*	102.9*	102.1*	103.9*	103.6*	101.7*	102.0*	103.5*	97.9*	102.2*	102.7*
Government Purchases	273.2	274.2	278.3	−1.9	−3.2	1.0	5.5	−0.2	1.4	1.8	2.1	1.7	0.4	1.5
Federal	98.6	99.2	101.6	6.9	−11.1	−2.8	12.3	1.5	3.0	2.4	1.5	−2.0	0.6	2.4
State and Local	174.6	175.0	176.7	−6.6	1.6	3.1	2.0	−1.2	0.5	1.5	2.4	4.0	0.2	1.0

E—Estimated

(1) Includes consumer purchases of homes and landlord's purchases of durable goods.

(2) Is roughly equivalent to capital spending.

(3) Exports less imports.

*All figures are dollars, not percent changes.

Table III
CRUDE OIL REFINERY ACQUISITION COST
(dollars per barrel)

	DOMESTIC	% change at annual rate	IMPORTED	% change at annual rate	COMPOSITE	% change at annual rate
1973	$4.17		$4.08		$4.15	
1974	7.18	72.1%	12.52	206.9%	9.07	118.6%
1975	8.39	16.9	13.93	11.3	10.38	14.4
1976	8.84	5.4	13.48	−3.2	10.89	4.9
1977	9.55	8.0	14.53	7.8	11.96	9.8
1978	10.61	11.1	14.57	0.3	12.46	4.2
1979 (Est.)	14.03	32.2	21.78	49.5	17.60	41.3
1980 (Est.)	22.00	56.8	32.00	46.9	26.50	50.6

Source: Department of Energy. Northwestern National Bank Estimate.

fourths of food prices. These costs can be traced to, once again, labor and energy. Given the kind of compensation and wage increases discussed earlier, a sizable increase in food price, regardless of commodity price fluctuations, is almost guaranteed.

The price of agricultural commodities, roughly a quarter of food prices, should have a moderating influence on food prices. The recession's impact on demand for meat will moderate increases in beef prices. Large supplies of pork and poultry will also dampen price rises. Assuming normal weather, prices of vegetables and grains should not increase very much.

If you eat out often, however, there will be little to cheer about. Once again, labor and energy costs will make dining out very expensive.

All in all, food prices in 1980 should record an 8 to 9 percent increase in 1980.

Industry Outlook

Indian summer is a period of mild, warm weather occurring in late autumn. Something along the lines of an Indian summer has been taking place in the economy. But, make no mistake about it, the most advertised, slowest developing recession in history is real.

One benefit of the economic Indian summer is that U.S. industries are well prepared for the current economic downturn. Contrary to the 1973-75 experience, inventories are lean and no significant labor hoardings have occurred. On the other hand, similar to the last recession, demand is softening in the face of double-digit inflation.

Table IV shows the relative impact of the 1973-75 recession on profits of various industries. Will the pattern repeat itself in 1980?

Relative Losers: Industries related to consumer big-ticket items such as automobiles and appliances should fare poorly. Firms supplying to these industries, such as steel, raw materials, etc., will also be impacted.

Construction industry, including residential and nonresidential building, and nonbuilding construction will suffer from high interest rates and a general economic recession. Suppliers to the construction industry, like lumber, steel and other building materials, may face difficult times.

Capital equipment industries, with the exception of high technology and information processing, will begin to feel the recessionary impact. Capital spending is typically a lagging sector of the economy. Therefore, the weakening orders and backlogs will become more pronounced as the year progresses.

Table IV
INDUSTRIES LESS IMPACTED BY 1973-75 RECESSION

Banks	Industrial Machines and Equipment
Computers	Medical Supplies
Containers	Office Equipment
Cosmetics	Oil Service
Drugs	Pollution Control
Electric Equipment and Supply	Printing and Publishing
Electric Utilities	Transportation Equipment
Food—Commodities, Packaged, Distillers	

INDUSTRIES MORE IMPACTED BY 1973-75 RECESSION

Airlines	Nonferrous Metals ex Aluminum
Aluminum	Paper
Apparel	Petroleum
Appliances	Property—Casualty Insurance
Automobiles	Retail Stores
Electronic Components	Steel
Home Furnishing	T.V.—Radio
Lumber	

As was true in 1973-75, airlines will be hit by a double-whammy of high fuel costs and softening passenger traffic. Also, financial institutions, which borrow short and lend long, may have problems since short-term interest rates may remain high by historical standards.

Relative Winners: In addition to the traditionally non-cyclical industries such as food, drugs, medical supplies and utilities, those industries which can make contributions to productivity gains at offices and factories should fare relatively well. Obvious examples are computer-related products, such as softwares, and information processing machines in offices.

Despite their gloomy sales picture, the automobile industry is in the process of retooling to downsize cars. Similarly, the airline industry will continue to expend huge sums to retool. Subcontractors and suppliers to the industries should benefit.

Finally, energy-producing industries will be candidates for good performance. Energy costs will rise substantially, more than offsetting weakening demand for energy. In the area of exploration and drilling for energy, massive sums will be spent benefitting industries in related areas.

Conclusion: Not too many industries will be able to hide from the onslaught of inflation and recession. Overall after-tax corporate profits are expected to decline 5 to 10 percent in 1980. On a trend basis, economic expansion toward year-end should reverse the decline in profits.

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